JUN 13 1956
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 174

RUPERT H. JOHNSON, R. H. JOHNSON & CO., and R. H. JOHNSON & CO., INC., *Petitioners*,

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT.

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v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit, entered in the above-entitled case on April 5, 1956.

OPINIONS BELOW

The findings and opinion of the Securities and Exchange Commission appear at page 1209 of the Joint Appendix. The opinion of the Court of Appeals (not yet reported) is attached as Appendix A.

JURISDICTION

The judgment of the Court of Appeals was entered on April 5, 1956. A copy of the judgment is attached as Appendix B. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1).

QUESTION PRESENTED

Whether the Securities and Exchange Commission may properly revoke the registration of petitioners —dealers long engaged in the securities business— upon the basis of findings of prior misconduct concerning which no evidence was taken and which petitioners had no opportunity to challenge, rebut or explain.

STATUTES INVOLVED

The statutes involved are the Securities Act of 1933, § 17(a), 15 U.S.C. § 77q(a); the Securities Exchange Act of 1934, §§ 10 and 15, 15 U.S.C. §§ 78j and 78o, and the Administrative Procedure Act, §§ 7 and 10, 5 U.S.C. §§ 1006 and 1009.

STATEMENT

By an order dated November 16, 1955, the Securities and Exchange Commission revoked the registrations of the partnership known as R. H. Johnson & Co., (the Firm), and the corporation known as R. H. Johnson & Co., Inc., (the Corporation), as brokers and dealers

in securities. The Commission also found R. H. Johnson, individually, a cause of such revocation. Securities Exchange Act of 1934, § 15(b), 15 U.S.C. § 78o(b). There actions were taken after a hearing, the adequacy and fairness of which is the sole issue presented here.

R. H. Johnson, the controlling figure in the Firm and Corporation bearing his name, has been engaged in the securities business for 33 years and has operated his present business for 28 years. On November 28, 1952, the Commission initiated proceedings against Johnson, the Firm, and the Corporation. These proceedings were later expanded to include four salesmen and two branch managers.

The Commission alleged that the individual salesmen had induced certain customers of the Firm to engage in securities transactions of relatively excessive size and frequency in relation to the nature of their accounts, and that the Firm obtained profits not disclosed to such customers, in violation of the anti-fraud sections of the securities laws.[1] Hearings were held before a Hearing Examiner, and the matter was then argued to the Commission. On November 16, 1955, the Commission issued the opinion and order complained of here. In this opinion it held that the four salesmen in question had in fact dealt with six customers in an unfair manner and had taken advantage of the inexperience of the customers in securities matters to induce the customers to engage in trading beyond what was reasonable and proper in

[1] Section 17 of the Securities Act of 1933, 15 U.S.C. § 77q and Sections 10 and 15 of the Securities Exchange Act of 1934, 15 U.S.C. 78j and 78o and Rules X-10B-5 and Rules 10-15C1-2 thereunder.

the light of the needs of the customers.[2] The Commission held that this action by the salesmen was a violation of the anti-fraud provisions of the securities laws cited above and that the Firm was responsible for the violations. It also held that R. H. Johnson, the dominant partner in the Firm, was responsible for the misconduct of the salesmen because he had failed to insure adequate supervision of the activities of the salesmen. No individual guilt on the part of R. H. Johnson was found and no misconduct or participation in the misconduct of the four salesmen was charged against Johnson individually. The basis for the finding against him was that he had failed adequately to supervise the salesmen in question.

The Commission on the basis of this conclusion revoked the Firm's right to do business and entered an order which if effective would exclude the Firm and any firm with which R. H. Johnson personally may be connected from the business of engaging in the purchase and sale of securities.

R. H. Johnson and Company was a very large firm with many branch offices, over 100 salesmen and between four and five thousand active customer accounts (J.A. 96, Johnson Exhibit No. 18). The violations in question related to the activities of only four of the salesmen in relation to six of the accounts. None of the salesmen were in the employ of the Firm at the time the Commission's order was entered, nor had they been for some time (Johnson Exhibit 18; Affidavit of Johnson, J.A. 20).

[2] It was also held that because of the relation of trust and confidence which it was found had been established between the salesmen and the customers in question, that the salesmen were under obligation to advise the customers of the profits made by the firm on some of the transactions and that they had failed to do so.

This drastic penalty—revocation of the right to do business because of failure to supervise four former salesmen in their dealings with a small fraction of the accounts of the firm—was a disproportionately severe punishment if the offense had been a first offense. Cf. *Bond & Goodwin, Inc.*, 15 S.E.C. 584 (1944); Loss, *Securities Regulation*, pp. 739-740 (1951). However, the Commission did not regard the situation as though it were a first offense. Its discussion of the subject of the revocation commences with an allegation relating to prior misconduct and prior disciplinary action. The first paragraph of the Commission's opinion under the heading "The Public Interest" reads as follows:

> "The Public Interest—
>
> "Under the provisions of the Exchange Act here applicable, we may revoke registrant's registration if we find it in the public interest. This is not the first time that disciplinary action has been taken against registrant. Registrant was expelled from membership in the NASD for inducing the excessive trading in the E account, and in our opinion sustaining the expulsion we cited previous sanctions imposed on registrant by the NASD and the New York Stock Exchange." (J.A. 1236).

The Commission then recites that "under all the circumstances" cited, including the alleged prior misconduct, revocation is appropriate.

It is not contested, however, that the record upon which the Commission rested its decision contained not so much as one syllable of testimony concerning the alleged prior misconduct and prior disciplinary action. During the course of procedings before the Hearing

Examiner, the Commisson's staff counsel stated his intention of producing witnesses who would testify as to prior misconduct and prior disciplinary action. He stated:

> "Mr. Reid: This evidence is offered primarily for one reason, that the Commission in the event it does find that the respondent has violated the particular fraud sections which are the essence of this case, we must consider whether it is in the public interest to revoke the registration of the respondent for such violations.
>
> "It is believed that this proof is material for such consideration and determination by the Commission * * *." (J.A. 888.)

Petitioners' counsel objected on the ground that such evidence would be appropriate only after a finding of violation. The Hearing Examiner ruled that such evidence would be proper, but the question being in doubt in his mind, referred the matter to the Commission. The intended witnesses were excused and no testimony was taken (J.A. 893 to 894). The Commission reversed the Hearing Examiner's ruling and held that the proffered proof was not admissible (J.A. 1139-1140). Accordingly, no testimony was taken on the subject of alleged prior misconduct or prior disciplinary action. The Hearing Examiner thereafter issued a recommended decision finding violations by the salesmen and holding the firm responsible but recommending leniency (J.A. 1201). His decision was not in any part based on any alleged prior misconduct. The record was never reopened by the Commission to produce any witnesses to testify about the alleged prior misconduct. Accordingly, the record is barren of any evidence on the subject of prior misconduct.

It was in this condition at the time the Commission on November 16, 1955, announced its judgment.

Yet the Commission's opinion was based upon the supposed prior misconduct. It cites no other basis for the order of revocation, being confined on this point to a recital of the previous "disciplinary action" and "sanctions" imposed on the Firm, and a rejection of certain circumstances offered in mitigation (J.A. 1236-1238).

The Commission's order was further extraordinary in that although respondents had been in business, as stated, for 28 years and Mr. Johnson for 33 years, the order was made immediately effective. It was only on being advised that petitioners had applied to the Court of Appeals for a stay that the Commission allowed ten days for that Court to consider the matter. It vigorously opposed a stay before the Court of Appeals pending appeal and has since opposed all stays granted by that Court. Thus had it not been for the application to the Court of Appeals, it would have been necessary for R. H. Johnson & Co. to close its doors immediately, after many years of business and suddenly to throw its many employees out of work.

This course of conduct and the vigor of the Commission's position can be explained only on the basis of its statement in its opinion that it believed it was dealing with a confirmed violator. This despite the fact that no evidence to that effect appears in the record.

The Court of Appeals affirmed the Commission's finding by opinion and judgment dated April 5, 1956, and this petition followed.

REASONS FOR GRANTING THE WRIT

1. As appears from the statement of facts, a severe penalty has been meted out to petitioners by an order of the Securities and Exchange Commission sanctioned by the Court of Appeals. This penalty, if affirmed, will result in the loss of a business of many years' standing and exclusion of petitioner Johnson from his lifelong occupation. The order is explicitly based upon an assumption by the Commission that it was dealing with parties with a long previous record of disobedience. Yet, that finding was made on a record which contained no evidence whatever with respect to this vital assumption. This is such a clear departure from the accepted course of judicial or administrative proceedings that it calls for the exercise of this Court's power of supervision. It is in direct conflict with the holdings of this Court and of other courts of appeals.

Petitioners agree that the Commisson has the right to consider evidence of past misconduct in seeking to determine what would be an appropriate penalty to be visited upon petitioners for violations found. What the Commisson did here, however, was to consider and give weight to such evidence *without making it a part of the record, without notice to the parties,* and *without giving petitioners any opportunity to challenge, explain or rebut it.* Precisely such procedure was condemned by this Court in *Ohio Bell Telephone Co.* v. *Public Utilities Comm.*, 301 U.S. 292. In that case the Public Utilities Commisson held hearings to fix rates for the telephone company. After the hearings were closed and without warning, the Commission revealed in its report that it had taken judicial notice of price trends, not in evidence, to aid in determining

appropriate rates. This Court held the Commission's order void for the following reasons:

> "* * * Without warning or even the hint of warning that the case would be considered or determined upon any other basis than the evidence submitted, the Commission cut down the values for the years after the date certain upon the strength of information secretly collected and never yet disclosed. The company protested. It asked for disclosure of the documents indicative of price trends, and an opportunity to examine them, to analyze them, to explain and to rebut them. The response was a curt refusal. . . . This is not the fair hearing essential to due process. It is condemnation without trial.
>
> "An attempt was made by the Commission and again by the state court to uphold this decision without evidence as an instance of judicial notice . . . . notice even when taken, has no other effect than to relieve one of the parties to a controversy of the burden of resorting to the usual forms of evidence. . . . 'It does not mean that the opponent is prevented from disputing the matter by evidence if he believes it disputable.' Ibid. * * *" (301 U.S. 300-302.)

Procedure such as that upheld by the Court of Appeals was also condemned by this Court's holdings in *United States* v. *Abilene and So. Ry. Co.*, 265 U.S. 274 and *Morgan* v. *United States*, 304 U.S. 1. In *Abilene*, this Court declared that "nothing can be treated as evidence which is not introduced as such." 265 U.S. 288.[3]

The ruling of the court below is also in direct conflict with the decision of the Sixth Circuit Court of Appeals

[3] These two cases were recently approved by the Court in *Gonzales* v. *United States*, 348 U.S. 407, 413, 414.

in *Powhatan Mining Co.* v. *Ickes*, 118 F. 2d 105 (C.A.A. 6, 1941). There the court pointed out that the broader the power of an agency to notice facts outside the record, "the more scrupulous should be the effort on the part of the agency to extend to the litigant the right to test evidence thus admitted by the fullest possible cross-examination." (118 F. 2d at 110).

The procedure utilized here by the Commission was expressly condemned in the *Final Report of the Attorney General's Committee on Administrative Procedure* (1941). It was there said that whenever facts are judicially noticed the parties "are entitled not only to refute, but, what in this situation is usually more important, to supplement, explain and give different perspective to the facts on which the agency relies." (P. 72).[4]

Section 7(d) of the Administrative Procedure Act, 5 U.S.C. § 1006, specifically provides that:

> "The transcript of testimony and exhibits, together with all papers and requests filed in the proceeding, shall constitute the exclusive record for decision in accordance with section 8 . . . Where any agency decision rests on official notice of a material fact not appearing in the evidence in the record, any party shall on timely request be afforded an opportunity to show the contrary."

This section makes clear that parties to proceedings are entitled to answer any facts considered by the agency outside the record by means of official notice.

[4] See also Note, "*The Relationship of Official Notice to the Substantial-Evidence Rule in the Judicial Review of Administrative Adjudications*," 60 Harv. L. Rev. 620 (1947); Gellhorn, *Administrative Law*, pp. 553-601 (1947); Davis, *Administrative Law*, p. 476, et seq. (1951).

Yet, no opportunity was given to these petitioners to meet the allegations of prior misconduct relied upon by the Commission in imposing the severe penalty of revocation.

Indeed, as we have seen, at the hearing before the Commission a proffer of evidence of prior misconduct was excluded by a ruling of the Commission itself. This made it unnecessary for plaintiffs to meet or explain this allegation. Further, the Hearing Examiner's initial decision placed no reliance on alleged prior misconduct. *The petitioners had no intimation that supposed prior misconduct was to be considered before the Commission issued its final order, effective immediately, on November 16, 1955.*

The procedure used by the Securities and Exchange Commission in the present case was a clear denial of the basic elements of a fair hearing. Due process of law embraces not only the right to present evidence but also an opportunity to meet and answer the claims of the opposing side. *Morgan* v. *United States, supra*, at p. 18 of 304 U.S. Here the petitioners got no hearing at all on facts which turned out to be crucial to the result of their case. This Court should not permit such a flagrant departure from its accepted rulings.[5]

2. Before the Court of Appeals, the Securities and Exchange Commission did not deny (as it could not) that its decision was based on the alleged prior misconduct of petitioners. It did not deny that the record contains no evidence of such alleged prior misconduct.

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[5] ". . . Fastidious regard for the honor of the administration of justice requires the Court to make certain that the doing of justice be made so manifest that only irrational or perverse claims of its disregard can be asserted." *Communist Party* v. *Subversive Activities Control Board*, ——— U.S. ———, April 30, 1956.

It did not defend the propriety of making a decision based on evidence not in the record. Instead, in the Court below, its counsel made two technical defenses designed to suggest that petitioners had no right to raise this question of fundamental denial of due process. These technical objections are afterthoughts of counsel, not mentioned in the Commission's opinion, and, in addition, are clearly without merit.

(A) It was suggested by the Commission counsel that the issue of previous misconduct is *res judicata*. They relied on a previous proceeding involving disciplinary action by the National Association of Securities Dealers against petitioner, relating to one of the salesmen and one of the accounts also involved in the present proceedings.

Fundamentally this plea must fail because the Commission gave no notice in the record that it intended to rely on the previous proceedings as *res judicata*. As this Court has stated, *res judicata* is applicable only where the previous judgment alleged to be *res judicata* is pleaded as such. *United States* v. *Bliss*, 172 U.S. 321, 326, states:

> "If a party neither pleads nor proves what has been decided by a court of competent jurisdiction in some other case between himself and his antagonist, he cannot insist upon the benefit of res judicata, and this although such prior judgment may have been rendered by the same court."

By failing to advise petitioners that it intended to rely on the previous proceedings in this case, the Commission denied the petitioner an opportunity (a) to argue that the issue was not *res judicata*, as it clearly

was not,[6] and (b) to bring in evidence to establish that the alleged prior misconduct was either not misconduct or was of such a character or occurred so long ago as to be irrelevant to the issue of a present penalty. By bringing up the *res judicata* question in the courts as an afterthought, counsel seeks to aggravate the effect of denial to petitioners of an opportunity to refute the charge of prior misconduct.

(B) The other technical defense of the Commission is a claim that petitioner was required to seek a rehearing before raising the issue of the Commission's erroneous reliance on unproved prior misconduct. This contention runs counter to the Administrative Procedure Act and to the decisions of this Court, which establish that an application for rehearing is not a necessary prerequisite to judicial review. The court review section of the Administrative Procedure Act, § 10(c), 5 U.S.C. § 1009(c), provides:

> "Except as otherwise expressly required by statute, agency action otherwise final shall be final for the purposes of this subsection whether or not there has been presented or determined any application for a declaratory order, for any form of reconsideration, or (unless the agency otherwise requires by rule and provides that the action meanwhile shall be inoperative) for an appeal to superior agency authority."

[6] The issues in the earlier proceeding were not identical to those here. In that proceeding the question was whether or not a penalty imposed by the National Association of Securities Dealers was excessive. In the present case the issue was what remedy should be imposed in the public interest, under the circumstances shown, to prevent future violations of law. Petitioners claim the right to be heard on the significance to be attached to the earlier proceeding, not an opportunity to dispute the existence of that proceeding.

Thus, an application for rehearing was unnecessary unless specifically required by statute.

The Securities Exchange Act of 1934, § 25, 15 U.S.C. § 78(y), unlike certain other statutes[7] does not require a petition for rehearing as a prerequisite to court review.[8]

But even had there been such a statutory provision, the Commission denied petitioners any opportunity to seek a rehearing. For, as we have seen, the Commission made its order effective immediately and opposed any stay. If petitioner had sought a rehearing, it would have suffered the sanction of being put out of business in the meantime. Plainly, petitioner was compelled to go to court to prevent closing its doors. Commission counsel here claims for the Commission the power immediately to destroy a substantial firm of many years' standing and cause the dismissal of its many employees, and yet to deny that firm access to the courts pending the filing and consideration of a petition for rehearing before the Commission. No such power exists.

Plainly, if the Commission intends to assert a right to have matters presented to it by petition for rehearing, it must withhold its sanction to permit persons subject to its jurisdiction to avail themselves

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[7] E.g., Natural Gas Act, 15 U.S.C. § 717r(a); Federal Power Act, 16 U.S.C. § 825*l*(g).

[8] Of course, as previously stated, the petitioner had objected vigorously to the use of evidence respecting prior violations when an attempt was made to introduce this evidence at the hearing. This objection was sustained by the Commission. A petition for rehearing could have served no purpose other than to reiterate a position previously stated by petitioners and accepted by the Commission in the proceedings.

of that right without losing their business in the interim. This is the teaching of the rulings of this Court. *United States* v. *Abilene & So. Ry. Co.*, 265 U.S. 274, 280-282; *Prendergast* v. *N. Y. Tel. Co.*, 262 U.S. 43, 48; *Levers* v. *Anderson*, 326 U.S. 219.

CONCLUSION

Petitioners in this case have been put out of business by an order of an administrative agency, which bars petitioner Johnson from the occupation in which he has been engaged for 33 years. In such circumstances this Court has decreed that agency proceedings must adhere meticulously to the standards of fairness embodied in the concept of due process of law.

The Securities and Exchange Commission did not give petitioners a fair hearing in this case. Instead, the Commission relied upon evidence never introduced into the record and as to which petitioners had no knowledge until the hearing was closed and the Commission's final order became effective. This is such a clear defiance of the repeated rulings of this Court as to call for the exercise of its supervisory power.

For the foregoing reasons, this petition for certiorari should be granted.

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JUNE 1956

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 12,977

R. H. JOHNSON & CO., a Partnership, et al., *Petitioners*

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent*

Petition for Review of Order of
Securities and Exchange Commission

Opinion

Decided April 5, 1956

Mr. Milton S. Gould, one of the bar of the Court of Appeals of New York, *pro hac vice*, by special leave of Court, for petitioners. Mr. James R. Browning was on the brief for petitioners.

Mr. Arden L. Andresen, Special Counsel, Securities and Exchange Commission, with whom Messrs. William H. Timbers, General Counsel, Securities and Exchange Commission, Thomas G. Meeker, Associate General Counsel, Securities and Exchange Commission, and Ellwood L. Englander, Attorney, Securities and Exchange Commission, were on the brief, for respondent.

Before Wilbur K. Miller, Bazelon and Bastian, Circuit Judges.

Per Curiam: The petitioners, R. H. Johnson & Company, a partnership, R. H. Johnson & Company, Inc., and Rupert H. Johnson, seek review of an order of the Securities and Exchange Commission, entered November 16, 1955, which revoked the registrations of the partnership and corporation as brokers and dealers, and found Rupert H. Johnson was a cause of the revocation. The petitioners were found to have wilfully violated §§ 10(b) and 15(c)(1) of the

Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78 o(c)(1).

The voluminous record made in an exhaustive hearing amply supports the Commission's order.

Affirmed.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

April Term, 1956

No. 12,977

R. H. JOHNSON & COMPANY, a Partnership, et al., *Petitioners*

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent*

On Petition for Review of Order of the Securities and Exchange Commission.

Before: Wilbur K. Miller, Bazelon and Bastian, Circuit Judges.

Judgment

This cause came on to be heard on the record from the Securities and Exchange Commission, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is ordered and adjudged by this Court that the order of the said Securities and Exchange Commission on review in this cause be, and it is hereby, affirmed.

Dated: April 5, 1956.

Per Curiam.

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Clerk

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 174

RUPERT H. JOHNSON, R. H. JOHNSON & CO., and R. H. JOHNSON & CO., INC., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINION BELOW

The *per curiam* opinion of the Court of Appeals for the District of Columbia Circuit (Pet. App. 1a-2a) is reported at 231 F. 2d 523. The findings and opinion of the Securities and Exchange Commission appear at pp. 1209 *et seq.* of the Joint Appendix filed in the court below.

JURISDICTION

The judgment of the Court of Appeals was entered on April 5, 1956 (Pet. App. 2a). The petition for a writ of certiorari was filed on June 18, 1956. Peti-

tioners invoke the jurisdiction of this Court under 28 U. S. C. §1254(1).

STATUTES INVOLVED

The statutes involved are the Securities Act of 1933, Section 17(a), 15 U.S.C. 77q(a); the Securities Exchange Act of 1934, Sections 10, 15(b) and 25(a), 15 U.S.C. 78j, 78o(b) and 78y(a); and the Administrative Procedure Act, Sections 7 and 10, 5 U.S.C. 1006 and 1009. Also included is Rule XII(e) of the Commission's Rules of Practice. These provisions are printed in the Appendix hereto, *infra*, pp. 13-22.

QUESTION PRESENTED

Where the Securities and Exchange Commission found on the record that broker-dealers had acted fraudulently toward their customers—a finding which the court below held was amply supported by the record and is not disputed here—did the Commission, in finding that revocation of their registration was in the public interest, err in taking account of prior official disciplinary actions against these broker-dealers, without having put these prior actions formally into the record of the proceedings.

STATEMENT

Petitioners seek review of a judgment of the Court of Appeals for the District of Columbia Circuit affirming an order of the Securities and Exchange Commission, dated November 16, 1955, which, pursuant to Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78o (b), revoked the registrations of R. H. Johnson & Co., a partnership and R. H. Johnson & Co., Inc., as brokers and dealers in securities and, pursuant to Section 15A(b)(4) of that Act, 15 U.S.C. 78o-3(b)(4),

found R. H. Johnson individually to be a cause of the revocation.

The Commission found that petitioners and their employees sought and obtained the trust and confidence of customers who were uninformed and inexperienced in securities matters, and effected transactions, sometimes without the knowledge of the customer, which were excessive in volume and frequency in view of the resources of the customers and the character of their accounts, in order to obtain for petitioners excessive profits and commissions.[1] The Commission also found that petitioners had obtained secret and unlawful profits in some of the transactions.[2] Petitioners do not here contest the findings of fraud.

Petitioners' statement (Pet. 4) that "[N]o individual guilt on the part of R. H. Johnson was found and no misconduct or participation in the misconduct of the four salesmen was charged against Johnson individually" does not accurately reflect the record. On the

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[1] For example, in the Eaves account, an elderly widow and her spinister daughter placed with petitioners for investment about $50,000. Over a six year period there were effected 644 transactions (346 purchases and 298 sales) totaling over $1,000,000. The securities acquired in 216 of the purchases were sold within six months. Eighty-one percent of the purchases were reversed within one year. Over 50% of the transactions involved purchases, sales, repurchases and resales of 55 securities. Twenty-three repurchases occurred within three months of the sale, and 42 others within six months. Some securities were repurchased up to eight times. In a number of instances the repurchase was at a higher price than the price at which it had been sold (Jt. App. 1151-1156). As a result, the net capital in the account decreased $24,384. Petitioners' commissions and profits in this account amounted to $24,299.

[2] For instance, in the Ferry account, many of the confirmations were stamped with a legend stating that 5% was the maximum gross profit on the transaction. In 91 of these transactions, the actual profits ranged from 7% to 59% (Jt. App. 1166-1169).

contrary, the record shows that Johnson recklessly disregarded the interests of his customers, that he ignored and circumvented the Rules of the National Association of Securities Dealers (NASD) established to prevent such occurrences, that he discharged the clerical help necessary to maintain the records set up by the office manager as the only way to exercise adequate control of the salesmen, and that he had specific notice of at least some of the irregularities in these particular accounts, but took the position that "activity in itself is not a deterrent" if the account showed a profit (Jt. App. 1000-3,4), as accounts generally do in a rapidly rising market such as existed during this period.

Having made its findings with respect to petitioners' fraud, the Commission then turned to the question of what action should be taken in the public interest. In considering that question, the Commission said:

> "This is not first time that disciplinary action has been taken against registrant. Registrant was expelled from membership in the NASD for inducing the excessive trading in the E account, and in our opinion sustaining the expulsion we cited previous sanctions imposed on registrant by the NASD and the New York Stock Exchange."

The statement in the earlier opinion of the Commission to which reference was made is as follows:[3]

> "This is not the first time that disciplinary action has been taken against applicant. The NASD has twice before imposed sanctions upon applicant. * * * In 1946 it fined applicant $1,000 and costs because a branch office charged excessive markups

[3] Securities Exchange Act Release No. 4694, page 8.

in twenty-five transactions. In 1948 it suspended applicant for a period of thirty days because another branch office, without authorization by the customer, transferred the customer's contract for the purchase of when-issued stock to its own account and retained the profit realized on the subsequent resale.[11]

[11] We note also that in 1939 the New York Stock Exchange, of which applicant was then a member, fined it for employing persons without obtaining the required approval of the Exchange. In 1940, Johnson, at the suggestion of the Exchange, sold his seat in order to avoid certain disciplinary proceedings based on certain omissions in his membership application and misconduct by salesmen. Johnson claimed the omissions were not wilful but admitted that he had been negligent in supervising the firm's salesmen."

Under all the circumstances the Commission found it necessary and appropriate in the public interest to enter the order of revocation.

No petition for rehearing was filed with the Commission. Counsel for petitioners requested the Commission to grant a stay to enable them to file an application with the Court of Appeals for a stay pending review and the Commission granted a stay for 10 days.[4]

On review, the Court of Appeals for the District of Columbia Circuit affirmed the Commission's order in a *per curiam* opinion stating: "The voluminous record made in an exhaustive hearing amply supports the Commission's order" (Pet. App. 1a-2a).

ARGUMENT

This petition represents an unsuccessful attempt to create a procedural flaw upon which to overturn a de-

[4] Securities Exchange Act Release No. 5258.

cision based upon a course of fraudulent dealings so flagrant that no effort is here made to controvert the facts and so palpable that the Court of Appeals limited its opinion affirming the Commission's order to a short *per curiam* statement. Contrary to petitioners' assertion, the decision below is correct and presents no conflict or inconsistency with the rulings of any other court. We submit therefore that there is no call for further review.

1. Petitioners ask this Court to send the case back to the Commission for a new hearing, to be followed, no doubt, by subsequent appeals, on the naked and sole contention that they were prejudiced by the Commission's reference in its opinion to prior violations (*supra*, pp. 4-5), without any suggestion as to how they were prejudiced or what evidence they could properly offer if a new hearing were ordered. At no time since the institution of these proceedings, either orally or in any document filed with the Commission, the Court of Appeals, or this Court, have petitioners challenged the accuracy of the Commission's recital of the record of prior disciplinary actions nor have they indicated what arguments, if any, they could have made if they had availed themselves of the opportunity afforded them to do so (see *infra*, pp. 7-9). The reasonable inference is that their present contention is a drily "technical" one, wholly devoid of actual impact upon the substantive merits or propriety of the order of revocation. See Section 10(e) of the Administrative Procedure Act on the "rule of prejudicial error," App., *infra*, p. 22.

2. But petitioners' point does not even have a good "technical" basis. At an early point in the proceedings, the Commission upheld the objection of petition-

ers' counsel to evidence as to prior misconduct, which objection was made on the ground that the evidence was not material until there should be a finding of violation. In making his objection, petitioner's counsel stated: "let's get it very clear, he is a bad man anyway. He has had trouble before, but it doesn't belong here" (Jt. App. 891). However, the Commission necessarily would have to consider petitioners' prior conduct after it had determined that there were present violations. Past conduct and prior disciplinary actions are certainly material in the determination of the sanction to impose for new violations which have been found after a hearing.

This does not mean that the Commission then had to reopen the hearing, since it was content to rest upon matters as to which it could take official notice. That an administrative agency, in the course of the final decision, may take judicial notice (or official notice as it is termed in the Administrative Procedure Act) of facts outside the record is recognized by the Administrative Procedure Act. That Act, however, carefully safeguards such action and affords participants ample opportunity to controvert such noticed facts. Section 7(d) provides:

> "Where any agency decision rests on official notice of a material fact not appearing in the evidence in the record, any party shall on timely request be afforded an opportunity to show the contrary."[5]

[5] The Attorney General's Manual on the Administrative Procedure Act (1947) states at page 80:

> "* * * If official notice is taken of facts in the course of the final decision, the proceeding need not be reopened automatically, but the parties will be entitled to request reopening for the purpose of contesting the facts thus officially noticed by the agency."

Petitioners never made any "timely request" for "an opportunity to show the contrary" of the facts officially noticed, notwithstanding Rule XII(e) of the Commission's Rules of Practice, 17 C.F.R. 201.12(e), which provides for petitions for rehearing (App., *infra*, p. 22). In view of the fact that the Commission granted petitioners a stay of ten days within which to seek a judicial stay pending review in the Court of Appeals, petitioners may not now assume (Pet. 14) that the Commission would not have granted a stay pending consideration of a petition for rehearing before it.

It is beside the point (Pet. 14) that a petition for rehearing is not a mandatory prerequisite to an appeal. A party need not, as a prerequisite to appeal, request a rehearing to make the same contentions which have been fully explored during the proceedings. But if petitioners had any quarrel with the facts of which the Commission took official notice, they should have exhausted, at the administrative level, the remedy provided by the Administrative Procedure Act.[6] In this connection, it should also be noted that Section 25(a) of the Securities Exchange Act of 1934 provides, *inter alia*: "No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission." Cf.

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[6] "The cardinal principle of fair hearing is not that all facts must be in the record or that all facts must be subject to cross-examination but that parties must have a chance to meet in the appropriate fashion all materials considered. * * * The agencies should aggressively use all information they can reasonably bring to bear upon each case. So long as they give parties a chance to know the information and to meet it in the appropriate way their action will be well within the permissible limits marked out by Supreme Court decisions." Davis, *Administrative Law* (1951 edition), pp. 519, 520.

Federal Power Commission v. *Colorado Interstate Gas Co.*, 348 U. S. 492.[7]

3. The character of the matters as to which the Commission took official notice is also highly significant. In the prior proceeding against the same petitioners, the factual issue of their earlier misconduct was fully explored and the Commission's findings as to prior misconduct were based on evidence formally introduced in the hearings and which petitioners had full opportunity to controvert if they could do so. This factual determination was relevant to the question of sanction in both proceedings, and the standard, that of public interest, was identical. That determination as to petitioners' prior misconduct was reviewed by the Court of Appeals for the Second Circuit which held that "the Commission properly considered previous disciplinary action taken against the firm by the association and by the New York Stock Exchange." *Johnson, et al.* v. *Securities and Exchange Commission*, 198 F. 2d 690, 697, certiorari denied, 344 U. S. 855.

4. Revocation of registration is intended to exclude from the securities industry persons or firms from whom investors might suffer harm. Despite petitioners' references to revocation as a "penalty" or "punishment" (Pet. 5, 8, 11), it seems clear that protection of the public interest and not punishment is the object

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[7] *United States* v. *Bliss*, 172 U. S. 321 (Pet. 12) does not hold, as petitioner asserts, that the Commission could not take notice of an earlier decision as *res judicata* without "pleading" it. The case holds only that a party cannot insist on the benefit of *res judicata* unless he pleads or proves it. It would be strange indeed if an administrative agency, *sua sponte*, could not take notice of its own prior decision.

of Section 15(b).[8] But assuming, *arguendo,* that revocation is a penalty as petitioners contend, then, by analogy to criminal proceedings, all basis for their contention disappears. For in criminal proceedings the strict rules of evidence are limited to the primary question of violation, and do not extend to the problem of the sanction to be imposed. Courts have a wide discretion in using out-of-court sources of information to assist them in determining the extent of punishment to be imposed, including criminal records, affidavits, reports by probation officers, etc. *Williams* v. *New York*, 337 U. S. 241, 246-7.

5. The cases cited by petitioners in an attempt to create the appearance of conflict are in no way contrary to the decision below. The *Powhatan* case,[9] with which the petition claims a "direct conflict" (p. 9), turned on the use by the Government of tabulations compiled from secret data which were unavailable for proper cross-examination. There is no contention in the instant case that any of the facts referred to in the Commission's opinion were secret. On the contrary, as we have pointed out (*supra,* p. 9), they are matters of public record and were necessarily known to the petitioners.

The *Abilene* case[10] did not indicate that there was

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[8] The question of punishment is covered by Section 21(e) of the Act, 15 U.S.C., 78u(e), which authorizes the Commission to transmit evidence to the Attorney General for criminal prosecution. The fact that the Congress provided no alternative to outright revocation under Section 15(b) clearly demonstrates that the dominant purpose of the section is simply to protect investors rather than to punish violators.

[9] *Powhatan Mining Company* v. *Ickes*, 118 F. 2d 105 (C.A. 6).

[10] *United States* v. *Abilene and Southern Railway Co.*, 265 U. S. 274.

anything improper in the Interstate Commerce Commission's taking official notice of the items in tariffs and reports filed with it, but held that specific reference must be made to such data to preserve the rights of the parties. The *Ohio Telephone* case [11] was one in which the utility commission took notice of price trends in establishing rates. The thrust of the opinion was not that it was improper to take notice of these facts but that the utility commission had improperly refused to grant a rehearing to allow the company to contradict, explain, or rebut those facts. Similarly, in the *Morgan* case [12], where the Court held that the appellant had no opportunity "to know the claims of the opposing party and to meet them," the basic contention of the appellant which was sustained by the court was that its petition for a rehearing had been refused, and the case did not involve the problem of sanctions consequent upon proved violations.

Nothing in the opinions below indicates any disagreement with the principles set forth in these cases. The real issues in this case are basically factual ones and the proof of a fraudulent course of dealings was established to the satisfaction of the Commission and the Court of Appeals. There is no important question of law involved which requires review by this Court.

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[11] *Ohio Bell Telephone Co.* v. *Public Utilities Commission*, 301 U. S. 292.

[12] *Morgan* v. *United States*, 304 U. S. 1.

CONCLUSION

The decision below is correct. There is neither conflict nor need for further review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JULY, 1956

APPENDIX

1. The Securities Act of 1933, 48 Stat. 74, provides in pertinent part:

* * * * *

SEC. 17 (a) [15 U.S.C. 77q(a)]. It shall be unlawful for any person in the sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

2. The Securities Exchange of 1934, 48 Stat. 881, provides in pertinent part:

* * * * *

SEC. 10 [15 U.S.C. 78j]. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations

as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may perscribe as necessary or appropriate in the public interest or for the protection of investors.

* * * * * *

SEC. 15 (b) [15 U.S.C. 78o(b)]. A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration, which shall contain such information in such detail as to such broker or dealer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, such broker or dealer, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine.

An application for registration of a broker or dealer to be formed or organized may be made by a broker or dealer to which the broker or dealer to be formed or organized is to be the successor. Such application shall contain such information in such detail as to the applicant and as to the successor and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the applicant or the successor, as the Commission may by rules and regulations require as necessary or appropriate in the

public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine. Such registration shall terminate on the forty-fifth day after the effective date thereof, unless prior thereto the successor shall, in accordance with such rules and regulations as the Commission may prescribe, adopt such application as it own.

If any amendment to any application for registration pursuant to this subsection is filed prior to the effective date thereof, such amendment shall be deemed to have been filed simultaneously with and as part of such application; except that the Commission may, if it appears necessary or appropriate in the public interest or for the protection of investors, defer the effective date of any such registration as thus amended until the thirtieth day after the filing of such amendment.

The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to or revoke the registration of any broker or dealer if it finds that such denial or revocation is in the public interest and that (1) such broker or dealer whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions) or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, (A) has willfully made or caused to be made in any application for registration pursuant to this subsection or in any document supplemental thereto or in any proceeding before the Commission with respect to registration pursuant to this subsection any statement which was at the time and in the light of the circum-

stances under which it was made false or misleading with respect to any material fact; or (B) has been convicted within ten years preceding the filing of any such application or at any time thereafter of any felony or misdemeanor involving the purchase or sale of any security or arising out of the conduct of the business of a broker or dealer; or (C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security; or (D) has willfully violated any provision of the Securities Act of 1933, or of this chapter, or of any rule or regulation thereunder. Pending final determination whether any such registration shall be denied, the Commission may by order postpone the effective date of such registration for a period not to exceed fifteen days, but if, after appropriate notice and opportunity for hearing, it shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors to postpone the effective date of such registration until final determination, the Commission shall so order. Pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, after appropriate notice and opportunity for hearing, such suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors. Any registered broker or dealer may, upon such terms and conditions as the Commission may deem necessary in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal with the Commission. If the Commission finds that any registered broker or dealer, or any broker or dealer for whom an application for registration is pending, is no longer in ex-

istence or has ceased to do business as a broker or dealer, the Commission shall by order cancel the registration or application of such broker or dealer.

* * * * *

SEC. 25 (a) [15 U.S.C. 78y(a)]. Any person aggrieved by an order issued by the Commission in a proceeding under this title to which such person is a party may obtain a review of such order in the Circuit Court of Appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the Court of Appeals of the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith served upon any member of the Commission, and thereupon the Commission shall certify and file in the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, and enforce or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may

seem proper. The Commission may modify its findings as to the facts, by reason of the additional evidence so taken, and it shall file such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, and enforcing or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).

3. The Administrative Procedure Act, 60 Stat. 237, provides in pertinent part:

* * * * *

SEC. 7. [5 U.S.C. 1006]. In hearings which section 4 or 5 requires to be conducted pursuant to this section—

(a) PRESIDING OFFICERS.—There shall preside at the taking of evidence (1) the agency; (2) one or more members of the body which comprises the agency, or (3) one or more examiners appointed as provided in this Act; but nothing in this Act shall be deemed to supersede the conduct of specified classes of proceedings in whole or part by or before boards or other officers specially provided for by or designated pursuant to statute. The functions of all presiding officers and of officers participating in decisions in conformity with section 8 shall be conducted in an impartial manner. Any such officer may at any time withdraw if he deems himself disqualified; and, upon the filing in good faith of a timely and sufficient affidavit of personal bias or disqualification of any such officer, the agency shall de-

termine the matter as a part of the record and decision in the case.

(b) HEARING POWERS.—Officers presiding at hearings shall have authority, subject to the published rules of the agency and within its powers, to (1) administer oaths and affirmations, (2) issue subpenas authorized by law, (3) rule upon offers of proof and receive relevant evidence, (4) take or cause depositions to be taken whenever the ends of justice would be served thereby, (5) regulate the course of the hearing, (6) hold conferences for the settlement or simplification of the issues by consent of the parties, (7) dispose of procedural requests or similar matters, (8) make decisions or recommend decisions in conformity with section 8, and (9) take any other action authorized by agency rule consistent with this Act.

(c) EVIDENCE.—Except as statutes otherwise provide, the proponent of a rule or order shall have the burden of proof. Any oral or documentary evidence may be received, but every agency shall as a matter of policy provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence and no sanction shall be imposed or rule or order be issued except upon consideration of the whole record or such portions thereof as may be cited by any party and as supported by and in accordance with the reliable, probative, and substantial evidence. Every party shall have the right to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts. In rule making or determining claims for money or benefits or applications for initial licenses any agency may, where the interest of any party will not be prejudiced thereby, adopt procedures for the submission of all or part of the evidence in written form.

(d) RECORD.—The transcript of testimony and exhibits, together with all papers and requests filed in the proceeding, shall constitute the exclusive record for decision in accordance with section 8 and, upon payment of lawfully prescribed costs, shall be made available to the parties. Where any agency decision rests on official notice of a material fact not appearing in the evidence in the record, any party shall on timely request be afforded an opportunity to show the contrary.

* * * * *

SEC. 10. [5 U.S.C. 1009]. Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion—

(a) RIGHT OF REVIEW.—Any person suffering legal wrong because of any agency action, or adversely affected or aggrieved by such action within the meaning of any relevant statute, shall be entitled to judicial review thereof.

(b) FORM AND VENUE OF ACTION.—The form of proceeding for judicial review shall be any special statutory review proceeding relevant to the subject matter in any court specified by statute or, in the absence or inadequacy thereof, any applicable form of legal action (including actions for declaratory judgments or writs of prohibitory or mandatory injunction or habeas corpus) in any court of competent jurisdiction. Agency action shall be subject to judicial review in civil or criminal proceedings for judicial enforcement except to the extent that prior, adequate, and exclusive opportunity for such review is provided by law.

(c) REVIEWABLE ACTS.—Every agency action made reviewable by statute and every final agency action for which there is no other adequate remedy in any court shall be subject to judicial review. Any preliminary,

procedural, or intermediate agency action or ruling not directly reviewable shall be subject to review upon the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final shall be final for the purposes of this subsection whether or not there has been presented or determined any application for a declaratory order, for any form of reconsideration, or (unless the agency otherwise requires by rule and provides that the action meanwhile shall be inoperative) for an appeal to superior agency authority.

(d) INTERIM RELIEF.—Pending judicial review any agency is authorized, where it finds that justice so requires, to postpone the effective date of any action taken by it. Upon such conditions as may be required and to the extent necessary to prevent irreparable injury, every reviewing court (including every court to which a case may be taken on appeal from or upon application for certiorari or other writ to a reviewing court) is authorized to issue all necessary and appropriate process to postpone the effective date of any agency action or to preserve status or rights pending conclusion of the review proceedings.

(e) SCOPE OF REVIEW.—So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4)

without observance of procedure required by law; (5) unsupported by substantial evidence in any case subject to the requirements of sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided by statute; or (6) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party, and due account shall be taken of the rule of prejudicial error.

4. Rule XII(e) of the Commission's Rules of Practice provides:

> (*e*) Any petition for rehearing by the Commission shall be filed within 5 days after issuance of the order complained of and shall clearly state the specific grounds and the specific matters upon which rehearing is sought.

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JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 176

RUPERT H. JOHNSON, R. H. JOHNSON & CO. and R. H. JOHNSON & CO., INC., *Petitioners*,

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent*.

PETITIONERS' REPLY IN SUPPORT OF PETITION FOR CERTIORARI

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PETITIONERS' REPLY IN SUPPORT OF PETITION FOR CERTIORARI

The Commission's Brief in Opposition admits that the finding of prior misconduct on which the SEC order in question was based was made without evidence in the record.

The only justification advanced by the Commission is (1) that petitioner should have objected by petition for rehearing before the Commission, and (2) that this failure of due process on the part of the Commission was a "technical" one. It is plain, however, that by making a final order effective immediately the Com-

mission denied petitioner the opportunity to petition for rehearing thereafter. It is equally plain that if any denial of due process may be said to be "technical", this one is not. For, at the hearing if one is granted, it will be shown by the documents themselves and by external evidence that the alleged prior proceedings are irrelevant to the issue of public interest on which the Commission gave them controlling weight. Unless we are to assume the Commission will disregard the evidence which would be presented to it, there is no basis for the assumption that it will come to the same conclusion when the factual basis on which it acted is established to be non-existent.

1. We repeat that it is conceded by the Government that no evidence whatever was before the Commission of the alleged prior proceedings on which the Commission relied in its opinion. It is conceded that petitioners were entitled to an opportunity to object and present evidence. The only justification now advanced is that petitioners could have and should have objected to the Commission's opinion by a petition for rehearing before the Commission in accordance with a general rule of the Commission providing a five day period in which petitions for rehearing may be filed.[1]

Of course, if petitioners had a real opportunity to complain on petition for rehearing, they should have done so. But the Commission issued an order effective at once and thus deprived petitioners of any opportunity whatsoever to petition for rehearing.

[1] Before the Court of Appeals, the Commission's principal defense was that the alleged prior proceedings, no evidence of which appeared in the record, constituted res judicata. This argument apparently has been abandoned before this Court, for no mention of it appears in the Brief in Opposition.

The petitioner R. H. Johnson & Co. was a securities brokerage firm which had been in existence in that form for almost thirty years. It had a large organization with a great many salesmen and thousands of active customer accounts. It had done business in twelve states without criticism from any of them. Yet, on November 16, 1955, the Commission *with immediate effect* revoked the right of the petitioner to do business. In other words, on that day, unless a stay of the Commission's order was obtained, a thirty year old business was required to close its doors.

Under these circumstances, it is surprising for the Commission to suggest that petitioner was under an obligation to file a petition for rehearing before the Commission. Plainly, the fact that the Commission made its order effective immediately required immediate recourse to the courts to prevent the closing of petitioners' doors.

It seems to us elementary that if the Commission intends to assert a right to have objections presented to it by petitions for rehearing it must withhold its sanction to permit persons subject to its orders to avail themselves of that right without surrendering valuable property rights in the interim. See *United States* v. *Abilene & S. Ry. Co.*, 265 U.S. 274, 281, where the Court stated: "In this case, the order, by its terms, was not to become effective until 37 days after its entry. There was, consequently, ample time within which to apply for a rehearing and a stay, before the plaintiffs could have been injured by the order." 265 U.S. at 281.

Indeed this appears to be implicitly conceded by the suggestion of the Commission (Opp. Br. p. 9) that

petitioner might have asked for a stay of the order pending consideration of a petition for rehearing. The Commission does not and cannot say it would have granted such a stay. It appears in the record that on November 17, 1955, petitioners by telegram requested a ten-day stay "to take necessary steps in appeal procedure or *alternatively determine course of action* . . . " (R. 1273). The requested stay was *not* granted. Instead a ten-day stay was issued later the same day only after recourse to the Court of Appeals and the setting of the date by that Court for argument on a motion for stay (R. 1275).

But assuming, contrary to every indication, that a stay for the purpose of filing a petition for rehearing might have been forthcoming, that possibility is no substitute for a right to present evidence. The Due Process Clause and the Administrative Procedure Act (Section 7(d)) require that petitioner be given an absolute right to challenge the taking of notice of "facts". Section 7(d) says parties "shall" have a right to contest "facts" officially noticed. Those requirements are not satisfied if they are conditioned upon the discretionary grant by the Government of the right to continue to do business on application and as a matter of grace. See *Prendergast* v. *New York Telephone Co.*, 262 U.S. 43, 48, where the Court, after noting that a petition for rehearing did not stay the effectiveness of the order in question, stated: "As the law does not require an application for a rehearing to be made and its granting is entirely within the discretion of the Commission, we see no reason for requiring it to be made as a condition precedent to the bringing of a suit to enjoin the enforcement of the order"; *Levers* v. *Anderson*, 326 U.S. 219.

Here the Commission issued its order with immediate effect. It did not withhold its sanction to give an opportunity to protest. It spoke its final word. By so doing it subjected its order and decision to review by appellate courts with all its infirmities. It cannot complain that these infirmities were not pointed out to it before its order became final, because it gave no opportunity to petitioners to do so.

2. The Government also contends that the respondent's position is "technical". We do not know by what standards it can be assumed that any failure of due process is "technical". But in this case the importance of that failure is obvious. As its opinion shows, the only consideration the Commission gave to the question of public interest was on the basis of the alleged prior proceedings. Petitioners were given no opportunity to establish that these prior proceedings were irrelevant, to explain them in their setting, to present evidence as to the nature of the transactions in question and to show that they had absolutely no relation to the public interest. For example, (a) the major reliance of the Commission in this respect is on a previous NASD proceeding. That proceeding is inadmissible and irrelevant. It dealt with certain transactions with two ladies named Eaves by one of petitioner's salesmen. Those very transactions were testified to at length in the present proceedings (JA 371-457, 921-961) and discussed in detail in the Commission's opinion (JA 1214-1216, 1230). The fact that the NASD had previously come to an unfavorable view of the identical transactions can have no conceivable impact on the public interest.

Thus, the principal proceeding mentioned in the text of the Commission's opinion was entirely irrele-

vant to the issue. Other proceedings are mentioned in the SEC opinion only in a subordinate way and are subject to different infirmities. Insofar as the New York Stock Exchange "sanctions" are concerned, they relate to alleged non-compliance with rules of the New York Stock Exchange designed to assure the monopoly control of its membership, and having no relation to investor protection, which is the sole problem of concern to the Commission in its determination of public interest in this proceeding.[2] Concerning earlier NASD proceedings mentioned, had the facts been permitted to be presented as they will be if this Court reverses this case, they would establish that the transactions questioned were either thoroughly proper or of no relevance whatsoever to any interest in the protection of investors.

The harsh penalty imposed by the Commission in the present case was justifiable and justified only on the assumption that the Commission was dealing with a confirmed violator of regulations imposed to protect the public. A hearing on the issue would establish that there was no basis for the assumption. The Commission would then be required to consider what if any sanction is appropriate on the basis of the transactions before it, and not on the basis of other transactions not before it. To predict, as the opposition brief does, that the Commission would come to the same conclusion when the basis for it has been removed is to attribute a degree of irresponsibility to the Commission which neither the petitioners nor this Court can accept.

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[2] This is in addition to the fact that the Exchange is a private membership body against whose actions in most instances no legal redress exists.

CONCLUSION

The violation of due process is conceded. The argument that petitioner had an obligation or indeed an opportunity to petition for rehearing is contrary to the fact. Remand will serve not only to vindicate due process but will require the commission on reconsideration to give proper weight to the evidence which would be presented to it. We are confident it would then refrain from imposing the drastic sanction here involved.

The papers before this Court show that the court below sanctioned such a clear violation by the SEC of the course of procedure required by repeated rulings of this Court, as to require the exercise of its supervisory power.

The petition for certiorari should be granted.

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August 31, 1956.